United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

76-7616

To be argued by
BARBARA A. LEE

United States Court of Appeals

FOR THE SECOND CIRCUIT

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P/S

IN RE FRANKLIN NATIONAL BANK
SECURITIES LITIGATION

ROBERT GOLD, on behalf of himself and on behalf of all others similarly situated,

Plaintiff-Appellant,

—and—

LOUIS PERGAMENT,

Intervenor-Plaintiff-Appellant,

—against—

ERNST & ERNST, HAROLD V. GLEASON, PAUL LUFTIG, PETER R. SHADDICK, MICHELE SINDONA, CARLO BORDONI, HOWARD D. CROSSE, ANDREW N. GAROFALO, DONALD H. EMRICH, and ROBERT C. PANEPINTO,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

BRIEF OF APPELLEES

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Docket No. 76-7616

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QUESTION PRESENTED

Must a plaintiff who chooses to sue on behalf of a class of securities purchasers advance the cost (including the cost of identifying the class members) of forwarding the class action notice to members of the class whose securities were registered in "street" or nominee name?

STATEMENT OF THE CASE

This is a class action under Rule 23(b)(3), Fed. R. Civ. P., in which plaintiffs allege violations of the anti-fraud provisions of the federal securities laws (A21).[1/] Defendants are former officers, directors, employees and outside auditors of Franklin National Bank and its parent Franklin New York Corporation (A23-24). Plaintiffs contend that the published financial statements of the bank and its parent were deficient in various respects between January, 1973, and May, 1974 (A26).

The class certified by the Court below includes "all purchasers of common stock, preferred stock, or capital notes of Franklin New York Corporation who purchased any of such securities between July 16, 1973 and May 16, 1974" (A263). It is undisputed that a significant portion of the purchasers who constitute the class caused their securities to be registered in "street" or nominee name, although precise figures are not available (A83, A90, A205, A284-88, Pl.Br. 18). Only the record holders can be identified from the issuer's transfer sheets (A89), and these appear to include at least 661 nominees (A288). Where securities are held in "street" name, identification of the beneficial holders -- the actual members of the class -- requires resort to records of the brokers through

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1/ The Joint Appendix and the Record on Appeal are cited herein in the same manner as in the brief of plaintiffs-appellants, herein cited "Pl. Br."

whom they purchased (A207). Lists of persons who purchased a particular security during a specified period in the past are not, however, maintained by brokers in the ordinary course of business; the names and addresses of class members whose securities were held in "street" name would have to be compiled, especially for the purpose of this litigation, beginning with records nearly four years old (see A207-08). The mechanics of identifying class members for the purpose of forwarding notice to them is therefore a substantially different undertaking from that involved in forwarding, for example, proxy materials to the beneficial owners as of a given record date, since brokers do maintain that kind of record in the ordinary course (A207).

Following Judge Judd's opinion of April 5, 1976, defining the class and designating plaintiffs Gold, Pergament and Mendes as class representatives (R124), plaintiffs submitted a proposed order certifying the class and providing for notice (A45-54). The form of notice proposed by plaintiffs purported to "require" brokers and other record holders to forward the class action notice to the members of the class, but was silent on the issue of who would pay the expenses attendant upon such forwarding. Defendants therefore submitted a counter order providing for payment of such expenses by the class representatives.[2/] After a pre-trial conference at which the class

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2/ Defendants' proposed order differed from that submitted by the class representatives in certain other minor details not in issue on this ap-

representatives objected vigorously to advancing the expenses involved (A83-86), the issue was fully briefed by both sides (A120-219), and Judge Platt signed an order including the provision requested by defendants, as follows:

> "All costs and expenses incurred incident to the preparation and mailing of the Notice and the Request for Exclusion and Change of Address Form referred to therein, including but not limited to the cost of forwarding to beneficial owners by banks, brokerage firms and other institutions holding record title, shall be borne by the class representatives subject to further Order of the Court."

(A265, emphasis added). The same order approved a form of notice including the provision, proposed by plaintiffs, that

> "Banks, brokerage firms, and other institutions holding record title as of any day from July 16, 1973 through and including May 16, 1974 to Franklin securities beneficially owned by others are required to forward this notice to the beneficial owners." (A274)

The class representatives state for the first time on appeal that they are willing to bear the cost of mailing to the beneficial holders (Pl.Br. 20), but not the cost of identifying the persons to whom the mailing should be sent.[3/]

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peal (A58-61), most of which were resolved by agreement of the parties prior to the entry of the order appealed from (see A101-119, 125). Except for those specific differences, defendants' form of order followed the language of the one submitted by the class representatives almost word for word.

3/ Nothing turns on whether the record holder forwards to the beneficial holder a printed notice supplied to him by the class representative, or whether the class representative mails that notice directly to persons whose names and addresses are supplied by the record holder for the purpose (see Pl. Br. 4-5); the cost of the entire procedure, specifically including the costs of identifying the members of the class, will be the same in either event.

It appears from the record (A207), as well as from the position taken by brokers in recent litigation (pp. 23-24 infra), that notice sent to brokers who held Franklin securities for customers in "street" name is not likely to be forwarded to the actual class members unless the cost of identifying them is advanced. This appeal therefore clearly presents the Constitutional question whether the notice would satisfy the requirements of due process (and thus be binding on the class) if the provision at issue were stricken, as well as important public policy questions regarding the allocation of the costs of notice in class actions under the federal securities laws.

SUMMARY OF ARGUMENT

For a judgment in a class action under Rule 23(b)(3) to be res judicata as to the entire class, due process requires that notice of the pendency of the action be given in a manner reasonably calculated to reach the actual persons who will be bound by the judgment. In a class action on behalf of securities purchasers, because of the common practice of registering securities in "street" or nominee name, notice will not be reasonably calculated to reach the members of the class unless provision is made for identifying the beneficial purchasers.

The definition of the persons to be identified -- purchasers of particular securities during a specified period in the past -- is one created solely for the purposes of the particular

class action, and does not correspond to any list normally maintained by brokers or other nominees in the ordinary course of business. Class members can, however, be identified from brokers' trading records covering the years involved. Because the expense of extracting and compiling this information from records several years old is uniquely a function of the class representative's definition of the class he has volunteered to represent, payment should be advanced by the class representative in the first instance, not imposed upon strangers who are neither before the Court nor interested in the outcome of plaintiffs' suit. If class actions in securities cases are to be subsidized by the securities industry, that decision should be made by Congress, not the courts.

The order appealed from should be affirmed.

ARGUMENT

THE DISTRICT COURT CORRECTLY HELD THAT CLASS REPRESENTATIVES ARE REQUIRED TO ADVANCE THE COST OF FORWARDING NOTICE TO CLASS MEMBERS WHO PURCHASED SECURITIES IN "STREET" NAME, INCLUDING THE COST OF IDENTIFICATION

Although the provision for forwarding the class action notice to members of the class whose securities were registered in "street" or nominee name (A274) was included at plaintiffs' request, they argue on appeal that notice to record holders should be deemed sufficient for purposes of Rule 23 and due process, (Pl. Br. 20-29, 39-43, discussed in Point I, below).

In the alternative, plaintiffs urge that the cost of identifying the persons on whose behalf they have chosen to sue should be borne by persons not parties (Pl. Br. 30-38, 43-47, Point II below). The first of these alternatives could render any judgment herein subject to collateral attack. The second, wholly apart from the value judgments it requires with respect to allocation of the expense of financing class action litigation, might well render this action altogether unmanageable.

I. DUE PROCESS REQUIRES NOTICE REASONABLY CALCULATED TO REACH THE ACTUAL MEMBERS OF THE CLASS

Rule 23(c)(2), Fed. R. Civ. P., provides:

> "In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort."

"The best notice practicable under the circumstances" does not mean "whatever the plaintiff can afford"; it means the minimum notice necessary to satisfy the requirements of due process. In Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 176 (1974) ("Eisen IV"), the Supreme Court held that "there is nothing in Rule 23 to suggest that the notice requirements can be tailored to fit the pocketbooks of particular plaintiffs." This had been the law in this Circuit at least since the first appeal in the Eisen case eight years before, 391 F.2d 555, 570 (2d Cir. 1968) ("Eisen II"); see also 479 F.2d 1005, 1015 (2d Cir. 1973)

("Eisen III"). 4/ The "best notice practicable" language was inserted in the 1966 revision of Rule 23 not to authorize token gestures by economy-minded class representatives but to make clear that personal service of process on every member of a (b)(3) class was not required to make the judgment binding on members who did not opt out. As one distinguished judge expressed it:

> "To a generation raised on Pennoyer v. Neff, 95 U.S. 714, 24 L.Ed. 565 (1877), it is a rather heady and disturbing idea to be told that people in faraway places who receive a letter or are "described" in a newspaper "notice" which does not come to their attention are exposed to a binding judgment unless they take some affirmative action to exclude themselves."

Frankel, Some Preliminary Observations Concerning Civil Rule 23, 43 F.R.D. 39, 45 (1967); see also Advisory Committee Note to revised Rule 23, 39 F.R.D. 69, 107 (1966); 3B Moore, Federal Practice ¶23.55 (1977 ed.)

Adequate notice is, in short, crucial to the whole concept of Rule 23(b)(3) class actions. While due process in (b)(3) class actions does not require personal service on every member of the class, it does require notice given in a manner "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections," Eisen IV, 417 U.S.

4/ The decision of the Supreme Court is hereinafter cited "Eisen IV"; the 1968 and 1973 decisions of this Court as "Eisen II" and "Eisen III", respectively.

at 174, quoting with approval Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 315 (1950); accord, Greenfield v. Villager Industries, Inc., 483 F.2d 824, 831-32 (3d Cir. 1973).

The plain and unambiguous requirement that individual notice must be given to class members who can be "identified through reasonable effort" must be read in the same light. "Reasonable" does not refer to financial convenience, but to fundamental fairness:

> ". . . if . . . a considerable number of members of the class can be identified with reasonable effort, and financial considerations prevent the plaintiff from furnishing individual notice to these members, there may prove to be no alternative other than the dismissal of the class suit."

Eisen II, 391 F.2d at 570.

Plaintiffs, who would confine the broad teaching of the Eisen IV and Mullane cases to their own facts, argue that due process does not require individual notice to class members whose securities were registered in "street" name (Pl. Br. 20). This argument finds no support in the authorities on which plaintiffs rely.

In re Randolph-Wells Building Corp., 332 F.2d 963 (7th Cir. 1964), cert. denied, 379 U.S. 963 (1965) (Pl.Br. 21), held only that, in a corporate reorganization under Chapter X of the Bankruptcy Act, "reasonable efforts" do not require retaining professional searchers to track down the heirs and legatees of

persons on a forty-year old bondholder list.[5/] Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950) (Pl.Br. 21) held that, in a proceeding for settlement of the account of the trustee of a common trust fund, notice by publication was sufficient with respect to unknown or contingent beneficiaries and other persons "whose interests in the common fund are so remote as to be ephemeral," 339 U.S. at 317-18, but Constitutionally defective as to known beneficiaries. The lower court's decree settling the trustee's accounts was accordingly reversed. Although plaintiffs cite Mullane for the proposition that "individual notice to all beneficiaries was not constitutionally required," (Pl. Br. at 23), the passage plaintiffs quote occurs in the context of the Court's discussion of the reasons why personal service of process is not required:

> "Of course personal service even without the jurisdiction of the issuing authority serves the end of actual and personal notice, whatever power of compulsion it might lack. However, no such service is required under the circumstances. This type of trust presupposes a large number of small interests. The individual interest does not stand alone but is identical with that of a class. The rights of each in the integrity of the fund and the fidelity of the trustee are shared by many other beneficiaries. Therefore notice reasonably certain to reach most of those interested in objecting is

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5/ At least one District Court, while not expressly holding that due process so required, took the opposite approach in a Rule 23(b)(3) class action on behalf of securities purchasers, see Entin v. Barg, 412 F. Supp. 508 (E.D. Pa. 1976), discussed below, p. 17.

> likely to safeguard the interests of all, since any objections sustained would inure to the benefit of all. We think that under such circumstances reasonable risks that notice might not actually reach every beneficiary are justifiable."

339 U.S. at 319, quoted in part in Pl. Br. at 23 (emphasis plaintiffs'). Plaintiffs' reliance on this dictum is astonishing, for it is precisely because the "objections" of the class member in a Rule 23(b)(3) class action do not "inure to the benefit of all" -- i.e., because any class member who does not exercise his individual right to opt out is bound by the judgment -- that notice reasonably calculated to reach the actual members of the class must be given. See Eisen IV, 417 U.S. at 176, 177.

In the Mullane case, Justice Jackson discussed at some length what kind of notice is "reasonably calculated," in the real world, to reach the persons to whom it is actually directed:

> "But when notice is a person's due, process which is a mere gesture is not due process. The means employed must be such as one desirous of actually informing the absentee might reasonably adopt to accomplish it.
>
> * * *
>
> "In some situations the law requires greater precautions in its proceedings than the business world accepts for its own purposes. In few, if any, will it be satisfied with less."

339 U.S. at 315, 319-20; accord, Eisen IV, 417 U.S. at 174. Applying this test to the present case, it is clear that "the best

notice practicable under the circumstances" requires realistic provision for forwarding the notice to the actual members of the class, including identification of the significant percentage whose securities were registered in "street" or nominee name.

A. "STREET" NAME PURCHASERS CAN BE IDENTIFIED THROUGH REASONABLE EFFORT

Prior to the Supreme Court's decision in Eisen IV, when it was common for the cost of notice in class actions to be allocated partly or wholly to defendants, it was clearly the established practice in securities cases to require class members whose securities were held in "street" name to be identified from brokers' records so that notice could be forwarded to them directly, see, e.g, Werfel v. Kramarsky, 61 F.R.D. 674, 682 (S.D.N.Y. 1974); Miller v. Alexander Grant & Co., [1971-72 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶93,287 (E.D.N.Y. 1971); Berland v. Mack, 48 F.R.D. 121 (S.D.N.Y. 1969); Herbst v. Able, 47 F.R.D. 11, 17-19 (S.D.N.Y. 1969), modified on other grounds, 49 F.R.D. 286 (S.D.N.Y. 1970); accord, In re Memorex Security Cases, 61 F.R.D. 88, 103 (N.D. Cal. 1973). Indeed, this very procedure was involved in the Eisen case itself. Of the 6,000,000-member class in that case, the 2,250,000 members who were later held entitled to individual notice at plaintiff's expense were to be identified by means of computer records of the brokerage firms through whom their orders were placed.[6/] The

6/ Two million of them were customers of fourteen brokerage firms which effected odd-lot transactions by teletype; the remaining 250,000 invested through "monthly investment plans" or payroll deduction plans of NYSE member firms from whose records they could be identified, 52 F.R.D. at 257-58.

District Court was at pains to point out that notice to banks and brokers "by itself . . . would be far from satisfactory," Eisen v. Carlisle & Jacquelin, 52 F.R.D. 253, 267 (S.D.N.Y. 1971), rev'd on other grounds, 479 F.2d 1005 (2d Cir. 1973), vacated on other grounds, 417 U.S. 156 (1974) (emphasis added).

In the cases cited, no one was arguing, as plaintiffs are here, that the cost of identifying the class members should be separated from the cost of notice and paid for by someone else. Rather, the issue was what was the best notice practicable under the circumstances and all but one of the six district judges required individual notice to class members whose securities were held in "street" name. The exception was Eisen, where the District Court ordered individual notice to only 7,000 of the 2,250,000 class members who could be identified from brokers' records, 52 F.R.D. at 67. This Court, in reversing, held that all 2,250,000 were entitled to individual notice, 479 F.2d at 1009, and the Supreme Court agreed, 417 U.S. at 175.[7/]

7/ The class representative in Eisen did not argue, as plaintiffs do here that the effort required to identify these 2,250,000 persons from the brokers' records was unreasonable, although defendants had argued on the first appeal that identification was "virtually impossible," Eisen II, 391 F.2d at 569. After this Court ruled that an evidentiary hearing was required on that issue, ibid., the District Court found as a fact that approximately 2,250,000 class members could be identified from brokers' records of past trading and that the remaining two-thirds of the class could "not be identified with reasonable effort," 52 F.R.D. at 257. These findings were not disputed; the issues whether all of those persons were entitled to individual notice and who must bear the cost thereof were argued and decided in this Court and the Supreme Court on the assumption that securities traders identifiable from brokers' records are class members "who can be identified through reasonable effort," see 417 U.S. at 175; 479 F.2d at 1009.

Only two District Court cases have thus far presented the precise issue whether, in securities cases, class members who purchased in "street" name "can be identified through reasonable effort" within the meaning of Rule 23(c)(2). In Popkin v. Wheelabrator-Frye, Inc., [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,411 (S.D.N.Y. 1976), the class representative sent a special notice to banks, brokerage firms and other institutional holders "requiring them to identify each beneficial owner of Bell stock for whom they were nominee on the relevant dates," ¶95,411 at 99,089. Of the 220 known nominees to whom this notice was sent, only 41 responded, and only half the members of the class were identified. Id. at 99,090. Defendants accordingly moved for an order requiring plaintiff to make additional efforts to notify the remaining members of the class. Plaintiff, in what the Court characterized as "a posture unbecoming to a class representative," opposed the motion on two grounds, both of which are argued by plaintiffs in this case: that it was "tedious and expensive" and that purchasers in "street" name should be bound by notice to their nominees.

Judge Canella rejected both arguments. He held that the issue of expenses had been determined by the Supreme Court's holding in Eisen IV that "there is nothing in Rule 23 to suggest that the notice requirements can be tailored to fit the pocketbooks of particular plaintiffs," ¶95,411 at 99,090, quoting 417 U.S. at 176. With respect to plaintiff's second argument, he said:

> "While plaintiff is correct in asserting that notice to an agent (the nominee) for an undisclosed principal (the class member) binds the undisclosed principal, this abstract principle of law does not absolve plaintiff from complying with the mandate of Rule 23(c)(2)."

Accordingly, he squarely held that identification of class members whose securities were registered in "street" name "requires nothing more than 'reasonable effort' on plaintiffs' part." ¶95,411 at 99,090.

A contrary result was reached in the unreported decision in In re Clinton Oil Co. Securities Litigation, M.D.L. No. 137 (D. Kan., January 8, 1975), relied on by plaintiffs (Pl. Br. 28). In a 40-page memorandum devoted to redefining the classes and ruling on the legal sufficiency of some of the claims asserted, the Court gave no reason for its one-sentence conclusion that identification of the beneficial owners from brokers' records "would be unreasonable and not practicable." (Pl. Br., Exhibit A). There is nothing in the opinion to suggest why this Court should reach the same result.

What are "reasonable efforts" to identify class members in a particular case is a question of fact, see Eisen II, 391 F.2d at 569, which must be determined with reference to the real world. The Securities and Exchange Commission has characterized the practice of trading securities in "street" name as central to the whole system of securities transfer and

clearance,[8] and found that it is steadily increasing.[9] With respect to widely held, actively traded securities, the use of brokers and other nominees rises dramatically. The Street Name Study gave the following example:

> ". . . the 30 largest stockholders of Mobil Oil Corporation held 29% of its outstanding common stock; 26 of those stockholders were nominees which held 26%. Among the 30 largest shareholders of Ford Motor Company, 28 were nominees which held 33.9% of its outstanding common stock. With regard to United Airlines, 28 nominees held 45.1% of the outstanding common stock.[10]

8/ Final Report of the Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other Than the Name of the Beneficial Owner of Such Securities (December 3, 1976) at 11, hereinafter cited as Street Name Study, Final Report. That report, mandated by the 1975 amendments to the Securities Exchange Act of 1934, §12(m), 15 U.S.C. §78l(m), is reproduced as a pamphlet supplement to CCH Fed. Sec. L. Rep., No. 672, Part II (December 15, 1976). The Commission's earlier report to Congress dated December 4, 1975 (herein cited as Street Name Study, Preliminary Report), appears as No. 619, Part II (December 11, 1975).

9/ This conclusion, Preliminary Report at 8, is supported by industry statistics. The three most recent surveys by the New York Stock Exchange of corporations with 300 or more stockholders and $1 million or more in assets show that the percentage of shares held in nominee name increased from 23.7% in 1965 to 26.7% in 1970 and 28.6% in 1975. New York Stock Exchange, Share Ownership 1970 at 24 (based on census of 9,900 public corporations, 500 brokers and 400 banks, id. at 25); New York Stock Exchange, Share Ownership 1975 at 20 (11,000 public corporations, 300 brokers and 900 banks, id. at 23). American Society of Corporate Secretaries, 1974 Corporate Communications at 5, 7, reflects the same trends among the 715 members of the Society surveyed in 1974.

10/ Preliminary Report at 9, citing data from Subcommittees on Intergovernmental Relations and on Budgeting, Management and Expenditures of the Senate Committee on Government Operations, Disclosure of Corporate Ownership, S. Doc. No. 93-62, 93d Cong., 2d Sess. (1974).

In such circumstances, equating "purchasers" with "record holders" for the purposes of class action notice, as plaintiffs would do, flies in the face of reason and common sense. Not surprisingly, the courts have declined to do so. Several courts have in fact required substantially greater efforts to identify "street" name holders than the mere compiling of their names and addresses from brokers' records which plaintiffs here contend is unreasonable. For example, in Entin v. Barg, 412 F. Supp. 508 (E.D.Pa. 1976), where "a not inconsiderable number" of the securities involved had been held in "street" name, and some of the brokers involved had failed in the intervening years, the Court devised an extensive program of notice including two mailings, a publication program, hiring of a finding service to locate current addresses for potential class members, use of Freedom of Information Act requests to postmasters for forwarding addresses, and other techniques, 412 F. Supp. at 512. The opinion does not state who advanced these expenses. See also Seiffer v. Topsy's Int'l, Inc., 70 F.R.D. 622, 626 (D. Kan. 1976); In re Four Seasons Securities Laws Litigation, 63 F.R.D. 422, 427 (W.D. Okla. 1974), aff'd, 525 F.2d 500 (10th Cir. 1975); Street Name Study, Final Report at 15-17 and Appendix H (standard procedures for location of beneficial owners by issuers soliciting proxies).

It does not make sense to hold "unreasonable" that which had always been the accepted practice in the industry before plaintiffs began searching for ways to minimize the

financial impact of the Eisen decision. Plaintiffs' suggestion that the cost of identification has only recently become "unreasonable" because brokers have only recently "commenced a practice of sending bills to class representatives for reimbursement of such costs" (Pl.Br. p. 16) is at best disingenuous; prior to Eisen, these expenses were often imposed on defendants, as was done in the Eisen case itself, 54 F.R.D. 565, 567 (S.D.N.Y. 1972), rev'd, 479 F.2d 1005 (2d Cir. 1973), vacated, 417 U.S. 156 (1974). "Reasonable effort" to identify class members clearly requires consulting records of the brokerage firms through which they purchased.

B. IDENTIFICATION OF "STREET" NAME PURCHASERS IS THE MINIMUM REQUIRED TO GIVE THE "BEST NOTICE PRACTICABLE UNDER THE CIRCUMSTANCES"

1. Notice to Nominees Without Provision for Payment of Forwarding Expenses is Unlikely to Reach the Actual Members of the Class.

In an effort to create the impression that a class action notice sent only to record holders will somehow reach the actual members of the class, plaintiffs argue that brokers have a fiduciary duty to customers which requires them to identify past customers and forward outsiders' communications without compensation (Pl.Br. 40-43). Plaintiffs rely principally on authorities which stand for the general principle that a broker, like other agents, stands in a fiduciary relationship to his principal with respect to matters within the scope of the

agency.[11/] The agent's obligation to deal honestly with his principal does not, however, require him to subsidize the litigation expenses of every volunteer who may wish to communicate with his past customers. To the extent that the unreported order in In re Clinton Oil Co. Securities Litigation, M.D.L. #137 (D. Kan. April 5, 1976) (Pl.Br. 42), represents contrary authority, we respectfully submit that it should not be followed in this Circuit.

The one other authority cited by plaintiffs on this issue holds exactly the opposite of the proposition for which it is cited. In Karl E. Sommerlatte, [1971-72 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶78,557 (October 8, 1971), an attorney submitted the following inquiry to the SEC's Division of Trading and Markets:

> ". . . when a brokerage firm holds corporate bonds or convertible debentures in a customer's account and such securities are called for redemption, is that firm required under any rules or regulations issued by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934 to give timely

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11/ Barnett v. United States, 319 F.2d 340 (8th Cir. 1963); Opper v. Hancock Securities Corp., 250 F. Supp. 668 (S.D.N.Y.), aff'd, 367 F.2d 157 (2d Cir. 1966); Selcow v. Floersheimer, 20 A.D.2d 889, 248 N.Y.S.2d 934 (1st Dep't 1964); Hurley v. John Hancock Mut. L. Ins. Co., 247 App. Div. 547, 288 N.Y. Supp. 199 (4th Dep't 1936); 1 Scott, Trusts 134 (3d ed. 1967) (Pl. Br. 40-41). The "abstract principle" that notice to the agent should bind the principal has been expressly held inapplicable to absolve a class plaintiff from sending notice to class members whose stock is held in "street" name, Popkin v. Wheelabrator-Frye, Inc., [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,411 (S.D.N.Y. 1976), quoted above, p. 15, and does not in any event apply where, as here, the sender is on notice that the communication is unlikely to be forwarded, Hurley v. John Hancock Mut. L. Ins. Co., supra, 288 N.Y. Supp. at 204; accord, Tree Plateau Co. v. Mount Vernon Mills, Inc., 22 A.D.2d 587, 257 N.Y.S.2d 733 (1st Dep't 1965).

> notification to the customer so that he may exercise any option or privileges he may have prior to the date of call [?]"

Plaintiff cites the Division's reply for its reminder of the potential applicability of the antifraud provisions, included in no-action and interpretive letters as a matter of course (Pl. Br. 42). The staff's answer to the specific question posed, however, was that apart from the proxy rules and Rule 10b-17, not here relevant, "there are no provisions under the federal securities laws specifically relating to notices of the kind you mention in your letter." ¶78,557 at 81,202.

Plainly, under existing law, brokers have no duty to forward communications to past or present customers even from the issuer, much less from third parties such as class action plaintiffs, unless reimbursed for the expense. The only express duty brokers have under regulations presently in effect is the duty to forward issuers' proxy materials to beneficial holders, and that duty arises only when the person soliciting the proxies "shall furnish" the brokers, among other things,

> "satisfactory assurance that he will reimburse such member organization for all out-of-pocket expenses, including reasonable clerical expenses, incurred by such member organization in connection with such solicitation."

New York Stock Exchange Rule 451; American Stock Exchange Rule 576.[12/] The exchanges have interpreted these rules as

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12/ 2 N.Y. Stk. Exch. Guide (CCH) ¶2451 (hereinafter cited "NYSE Guide");

requiring transmittal of issuers' annual reports on the same conditions, although annual reports are not "proxy-soliciting material," NYSE Guide ¶2451.10; Amex Guide ¶9528.10. The recent SEC Street Name Study recommended that this obligation be extended to "all communications which an issuer supplies and for the forwarding of which the issuer reimburses the broker's reasonable expenses," Final Report at 7. The Commission has not yet taken any action on this recommendation. Significantly, under existing law, the issuer is under a corresponding obligation "upon the request of such record holder, [to] pay its reasonable expenses for completing the mailing of such material to security holders to whom the material is sent," 1934 Act Rule 14a-3(d), 17 C.F.R. §240.14a-3(d). The Street Name Study did not recommend any change in this respect.

In the court below, plaintiffs attempted to distinguish these authorities on the ground that they dealt only with the obligations of brokers to issuers, not to their own customers or to outsiders such as the plaintiffs in class action litigation (A216). Since the subject of these rules is how a broker may obtain his customer's instructions on voting

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2 Am Stk. Exch. Guide (CCH) ¶9528 (hereinafter "Amex Guide"). The Board of Governors of the National Association of Securities Dealers has interpreted Article III, Section 1 of its Rules of Fair Practice as imposing the same requirements on its members, NASD Manual (CCH) ¶2151.05, §2. The exchanges and the NASD have approved a fee schedule for such mailings, 2 NYSE Guide ¶2465.20; 2 Amex Guide ¶9528.80; NASD Manual ¶2151.05, §5, and the exchanges have even prescribed the form of bill to be used by member organizations, NYSE Guide ¶2465.30; Amex Guide ¶9537.30.

a proxy, and when he may give a proxy without instructions, NYSE Rules 450-460, NYSE Guide ¶¶2450-2460; Amex Rules 575-585, Amex Guide ¶¶9527-9537, it is plain that the exchange member's obligation to his own customer is precisely the duty with which they deal, and it is equally plain that that duty does not require the broker to perform services for which he is not compensated. Plaintiffs' attempt to distinguish issuers from outsiders such as class representatives actually cuts the other way. If the Commission and the stock exchanges have conditioned a broker's duty to forward an issuer's proxy material and annual reports to present customers on the payment of the broker's reasonable expenses, the same condition must certainly apply to outsiders who desire to communicate with the broker's past customers for their own purposes. This is particularly so when it is remembered that forwarding an issuer's proxy materials or annual report to persons holding beneficially as of the record date fixed by the issuer is a substantially simpler and less expensive process than that involved in compiling the identities of class members from records several years old (see A207). Plaintiffs' argument requires a finding that a broker has a greater duty to an outsider than to the issuer of the securities he holds for his customer, not only to perform gratis for the stranger a service for which he is entitled to compensation from the issuer, but to compile at his own expense from records several years old the identity of the class with whom the self-appointed representative seeks to communicate.

Such a result would be as unfair as it is illogical.

In the absence of any legal duty to transmit outsiders' communications to their customers, brokers are understandably not willing gratuitously to undertake the burden and expense which plaintiffs themselves characterize as "enormous" (Pl.Br. 18). In Popkin v. Wheelabrator-Frye, Inc., [1975-76 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶95,411 (S.D.N.Y. 1976), replies were received from fewer than 20% of the brokers who actually received the "special notice" purporting to "require" them to identify the class members for whom they held in "street" name. In Jahre v. Rait, No. 74 Civ. 805 (E.D.N.Y. May 19, 1976), brokers not only requested compensation in advance for the cost involved in transmitting a notice of settlement to their customers, but commenced a special proceeding to vacate an ex parte order of the District Court purporting to require them to do so, In the Matter of the Order dated May 19, 1976 per the Hon. Jack B. Weinstein Purporting to Compel Various Brokerage Firms to Render Services Without Reimbursement, No. 76 Civ. 1305 (E.D.N.Y., filed July 12, 1976). Judge Weinstein's original order permitted the brokers to "request reimbursement for mailing costs or supply the names and addresses of such beneficial owners to Defendants' counsel, without cost," No. 74 Civ. 805, Order dated May 19, 1976, so that the expenses in issue, as in the present case, were those of identifying the class members. The brokers' petition to vacate

the May 19 order was granted by order filed October 15, 1976.[13/]

There is no reason to expect any different response to the provision in the class notice herein purporting to "require" the brokers to assume these burdens. Plaintiffs themselves have offered evidence of the current attitude of the securities industry toward this type of request, in the form of a letter from E. F. Hutton & Co., explaining exactly what is involved in identifying the class, what expenses the class representative would be required to advance, and what services the broker would perform without charge (A 207-08). If the expenses of identification are indeed as enormous as plaintiff contends, E. F. Hutton's attitude may be assumed to be typical. Clearly, then, unless the class representatives advance the cost of identifying the class members who purchased in "street" name, notice of this action will not be forwarded to that significant percentage of the class. In apparent recognition of what this means in practical terms, plaintiffs suggested below that the Court might enter an ex parte order directing the brokers to take the necessary steps to bring the notice to the attention of the beneficial holders (A213). How plaintiffs contemplate enforcing such an ex parte order is not clear, but if Constitutionally adequate notice to the class cannot be

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13/ Thereafter, all parties consented to an order dispensing with any further notice, id., Order dated October 20, 1976. The costs of notice in that case had been imposed upon the defendant corporation. Id., p. 2.

insured without resort to collateral subpoena enforcement proceedings against large numbers of brokers, this action may well be unmanageable.[14/]

2. The Authorities Cited by Plaintiffs are Distinguishable.

Plaintiffs attempt to wring from In re Four Seasons Securities Laws Litigation, 63 F.R.D. 422 (W.D. Okla. 1974), aff'd, 525 F.2d 500 (10th Cir. 1975) and National Student Marketing Litigation v. Barnes Plaintiffs, 530 F.2d 1012 (D.C. Cir. 1976), the proposition that notice to record holders is sufficient notice to class members whose securities were held in "street" name (Pl.Br. 25-27). Neither case so held. In both cases, the class action notice was in fact forwarded by brokers to their customers, 63 F.R.D. at 427; 530 F.2d at 1015,[15/] and the objecting class members were arguing that they were entitled to some special additional notice, more personal than that provided by the forwarding. In Four Seasons, a class member appearing pro se to object to

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14/ Plaintiffs argued below, without any supporting authority, that the brokers, as members of the class, should be deemed bound by any ex parte order affecting their rights (A213). This is not the law. On the contrary, the fact that class members may be bound by a final judgment in a (b)(3) class action does not necessarily make them parties to the litigation for any other purpose, see, e.g., In re Four Seasons Securities Laws Litigation, 525 F.2d 500, 504 (10th Cir. 1975). But this theoretical argument does not solve the problem of enforcement and the consequent inadequacy of the notice.

15/ The cost of notice in the Four Seasons case was paid by defendants, 63 F.R.D. at 431. The opinion of the Court of Appeals in National Student Marketing does not state who bore the expense in that case.

the substantive provisions of the settlement argued that the notice should have been personally served on him in the manner of original process, 63 F.R.D. at 425. He had not only received the notice forwarded to him by his broker, but had filed his proof of claim and received a check, 63 F.R.D. at 424, facts which the Court held made the judgment res judicata as to him. In National Student Marketing, a group of 38 class members who had commenced independent actions moved for exclusion six months after the opt-out period had expired. Although they argued that the notice was insufficient because 31 of the 38 held their stock in "street" name, not one of the 31 was willing to state under oath that he had not received the notice, 530 F.2d at 1015. The Court accordingly held that they had "failed to show by a preponderance of the evidence that they had not received the notice sent to all shareholders of record," id. at 1014, and rejected their contention that they were entitled to "unique and direct specific notice" by virtue of the fact that they had commenced their own actions, id. at 1015.

The only case which appears to have squarely held that notice to brokers was sufficient notice to "street-name" purchasers is In re Clinton Oil Co. Securities Litigation, M.D.L. #137 (D. Kan. April 5, 1976) (Pl.Br. 32), an unreported opinion in which the conclusion is baldly stated without discussion. Other courts have been less willing to determine matters of Constitutional right on the strength of conclusory

assertions. In Girsh v. Jepson, 521 F.2d 153 (3d Cir. 1975), the proponents of a negotiated settlement submitted an affidavit which argued in conclusory terms, as plaintiffs do here, that notice to the record holders of the securities in question was "the best notice practicable under the circumstances." The Court of Appeals for the Third Circuit reversed the District Court's approval of the settlement, holding that an objecting class member should have been allowed to cross-examine the maker of the affidavit with respect to the adequacy of the notice proposed to be given.

Plaintiffs also argue that notice to record holders should be deemed sufficient under Rule 23(c)(2) because the laws of some states do not look beyond the record holder in a number of situations.[16/] This precise argument was expressly rejected in the one class action under the securities laws in which a District Court was called upon to consider it, Popkin v. Wheelabrator-Frye, Inc., quoted above p. 15, and should be rejected here for precisely the same reasons. In any event, both the federal courts and the Securities and Exchange Commission have rejected such a formalistic approach to construction of the federal securities laws, e.g., Drachman v. Harvey, 453

16/ E.g., Gruss v. Curtis Pub. Co., 534 F.2d 1396 (2d Cir.), cert. denied, 96 S.Ct. 240 (1976) (dissenters' rights of appraisal); see Drachman v. Harvey, 453 F.2d 722 (2d Cir. 1972) (standing to sue derivatively); U.C.C. §8-207(1) (Pl.Br. 39-40); but see Applications of Friedman, 184 Misc. 639, 54 N.Y.S.2d 45 (S.Ct. N.Y.Co.), modified on other grounds, 56 N.Y.S.2d 516 (1st Dep't 1945).

F.2d 722, 729 (2d Cir. 1972) (beneficial owner may bring derivative action arising under 1934 Act despite state statute restricting standing to record holder); SEC 1934 Act Rule 14a-8, 17 C.F.R. §240.14a-8, as amended, Fed. Reg. 52994 (Dec. 3, 1976) (beneficial owners of securities as well as record owners may submit proposals for inclusion in issuer's proxy statement); NYSE Guide ¶2452.11; Amex Guide ¶9529.11 (matters on which proxies may not be voted by record holders without instruction from beneficial owner).

Where, as here, the issue is not only the beneficial holders' statutory rights under the federal securities laws but their Constitutional right to due process, there is no basis whatever for determining the adequacy of notice by hypertechnical application of strained analogies. Notice in a (b)(3) class action under the federal securities laws should be given to the persons whose substantive rights are the subject of the litigation. The substantive rights here in issue clearly belong to the beneficial purchasers; plaintiffs do not go so far as to suggest that a broker can exercise his customer's right to "opt out" of this action, or file of claim on a customer's behalf.[17/] The beneficial purchasers, not the nominees who hold in "street" name on their behalf, are the persons whose rights will be

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17/ The validity of a broker's purported exercise of a customer's right of exclusion pursuant to Rule 23(c)(2)(A) is at best questionable, particularly in light of this Court's recent holding, albeit in a different context, that "opting out of a class action, like the decision to participate in it, must be an individual decision," Berry Petroleum Co. v. Adams & Peck, 518 F.2d 402, 412 (2d Cir. 1975).

adjudicated in the class action, and the beneficial holders are accordingly the persons entitled to notice.

C. DEFENDANTS ARE ENTITLED TO A JUDGMENT BINDING ON THE ENTIRE CLASS

Clearly, then, a procedure for notice which does not look beyond the record holder is not reasonably calculated to reach the actual members of the class plaintiffs seek to represent. Under the realistic criteria for determining the adequacy of notice prescribed in Mullane v. Central Hanover Bank & Trust Co., quoted at p. 11, supra, provision for identification and forwarding would seem to be the very minimum required in a realistic effort to reach these people.

Any other result would undermine the whole structure of Rule 23(b)(3) class actions, for if the form of notice employed is not reasonably calculated to reach the persons affected, they will not be bound by the judgment. Indeed, as one court has noted, defective notice which opens the judgment to collateral attack is in effect a return to the "one-way intervention" procedure which the 1966 revision of Rule 23 was intended to reverse, see Philadephia Elec. Co. v. Anaconda Amer. Brass Co., 43 F.R.D. 452, 459 (E.D. Pa. 1968).

In Greenfield v. Villager Industries, Inc., 483 F.2d 824 (3d Cir. 1973), settlement of a class action was overturned on appeal after distribution had been effected because requests for exclusion were required to be filed within 30 days of publication of notice, and the District Court denied the applications

of two brokers, not parties to the action, for an adjournment of the hearing in order to solicit their customers who were class members. The Court of Appeals for the Third Circuit stressed the key significance of adequate notice to the Constitutionality of the whole class action procedure:

> "A procedure such as the class action which has a formidable, if not irretrievable, effect on substantive rights, can comport with constitutional standards of due process only if there is a maximum opportunity for notice to the absentee class member, i.e., '[T]he best notice practicable under the circumstances including individual notice. . . .'
>
> "Given that class action procedures are conceptualized as an exception to the general rule that only parties to a lawsuit are legally bound by a final judgment, and that interested parties normally have a real voice in the strategy and management of the litigation, the procedure can be tolerated, if not completely justified, only if there is fealty to both the spirit and the letter of the procedural rules, especially those relating to notice."

483 F.2d at 831-32, footnotes omitted.

Judge Platt's holding that plaintiffs must bear the cost of forwarding the notice to beneficial owners, including payment of the reasonable cost of identification, is thoroughly consistent with this teaching and reflects an effort to conform the provision for notice in this case to conditions in the real world. Defendants are entitled to strict compliance with the notice requirements of Rule 23 to assure that the class on whose behalf plaintiffs sue will in fact be bound by any judgment or settlement that may be entered in this case. In re Four Seasons

Securities Laws Litigation, 63 F.R.D. 422, 429 (W.D. Okla 1974), aff'd, 525 F.2d 500 (10th Cir. 1975). Judge Platt's order assured that compliance and should be affirmed.

II. THE COSTS AT ISSUE ARE PROPERLY BORNE BY THE CLASS REPRESENTATIVES IN THE FIRST INSTANCE RATHER THAN BY PERSONS NOT PARTIES TO THIS LITIGATION

At the outset it must be pointed out that Judge Platt did not impose the costs of forwarding and identification on the "class as a whole," as plaintiffs repeatedly suggest (Pl.Br. 38, 43, 44). He held only that these expenses "shall be borne by the class representatives" in the first instance (A 265) -- i.e., plaintiffs Gold, Pergament and Mendes. If plaintiffs lose this case on the merits, the class representatives will not be entitled to recover the expenses of litigation from other members of the class, Lamb v. United Security Life Co., 59 F.R.D. 44, 48 (S.D. Iowa 1973). On the other hand, should they recover, these expenses will ordinarily be taxable as costs, see, e.g., Miller v. Alexander Grant & Co., [1971-72 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶93,287 (E.D.N.Y. 1971). The issue, therefore, is whether the expense of notice to class members whose securities were registered in "street" name is to be advanced by the plaintiffs who have volunteered as the champions of the rights of the class, or imposed on persons not parties to this litigation. Underlying this narrow issue is the broader policy question whether class actions are to be financed by the persons who initiate them or subsidized, regardless of merit, by the securities industry.

Plaintiffs' contention that the "weight of authority" permits the class representatives to pass these costs on to brokers and other nominees (Pl.Br. 30) does not survive analysis of the four cases cited for this proposition.

The first two cases on which plaintiffs rely, In re Penn Central Securities Litigation, 416 F.Supp. 907 (E.D. Pa. 1976), appeal pending, No. 76-2139 (3d Cir., filed July 19, 1976) (Pl.Br. 30) and Judge Williams' oral ruling in Kushner v. Ampex Corp., No. C 72-360 (N.D. Cal. Nov. 15, 1976) (Pl. Br. 31), both considered applications of brokers for reimbursement out of funds paid into court for distribution to the class pursuant to settlement agreements, after notice had been given and proofs of claim filed. There is no settlement fund in this case, and no question of imposing these costs on the entire class. The Penn Central case, in which the applications for attorneys' fees and other expenses substantially exceeded the percentage permitted by the terms of the settlement, 416 F.Supp at 913, is questionable authority in any event, for the Court denied the brokers' applications on the ground that

> "There is simply no reason to require the entire class to pay for the choice of a few to have their stock held in street name."

416 F. Supp. at 921. As we have seen (p. 16, supra), there is no basis for supposing that class members whose stock was held in "street" name are few in number; in Popkin v. Wheelabrator Frye, Inc., p. 14, supra, they were half the class.

Plaintiffs also rely heavily on Blank v. Talley Industries, Inc., 54 F.R.D. 627 (S.D.N.Y. 1972) (Pl. Br. 33) and In re Clinton Oil Co. Securities Litigation, M.D.L. No. 137 (D. Kan. April 5, 1976) (Pl.Br. 32). In both cases, class representatives were relieved of the cost of identification of class members who held in "street" name on the theory that the matter was one for discovery, rather than part of the cost of notice. Blank held only that the District Court had discretion to impose these costs on the single broker there involved, and the unreported order in Clinton merely cited Blank without discussion.

Blank v. Talley Industries is, however, no longer the law in this Circuit. In Sanders v. Levy, No. 75-7608, 21 Fed. Rules Serv. 2d 1213 (2d Cir. June 30, 1976), this Court expressly held the discovery rules inapplicable to identification of class members for the purpose of giving notice:

> "....the cost of obtaining the name and address to be affixed to the envelope does not differ in kind from the cost of printing the notice and of procuring, stuffing and posting the envelopes."

(slip. op. at 4587-88, 21 Fed. Rules Serv. 2d at 1218). The Court also rejected the class representative's invitation to carve out an exception to the Eisen rule and permit costs to be imposed on a non-party that could not be imposed on a defendant, slip op. at 4583-84, 21 Fed. Rules Serv. 2d at 1215-16. It held that the relationship between a class representative and a person not a party to the class action is "not non-adversarial in a manner which requires an exception to the Eisen IV rule

on notification costs, but in a manner that makes it totally improper to impose costs on the Fund." Ibid.

That would end the matter, as plaintiffs concede (Pl. Br. 24), but for the pending reconsideration en banc of the panel's decision in Sanders v. Levy.[18/] Should that decision be modified or reversed, there are nevertheless independent reasons for affirming the order appealed from in this case.

Should this Court en banc rule that the cost of identification is governed by the discovery rules, as the dissenting judge in Sanders v. Levy thought (slip op. at 4593-95, 21 Fed. Rules Serv. 2d at 1221-22), Judge Platt's imposition of these costs on the plaintiffs in this case should be affirmed as a proper exercise of his discretion. Since this Court held in Eisen III, 479 F.2d at 1015, and the Supreme Court agreed in Eisen IV, 417 U.S. at 177, that a District Court may not inquire into the merits of a class action prior to certification, the only meaningful deterrent to frivolous class actions is the requirement that the self-appointed class representative bear, at least in the first instance, "the ordinary burden of financing his own suit", Eisen IV, 417 U.S. at 179. Even so,

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18 / Recognizing that "the existing Sanders v. Levy decision is, of course, the law in this Circuit," Pl.Br. at 24, plaintiffs attempt to distinguish that case on the ground that it dealt with identification of registered owners rather than persons whose stock is held in "street" name, Pl. Br. at 37. That technical distinction, however, is entirely dependent on plaintiffs' argument that notice to registered owners is the only notice required to be given. Once it has been determined that notice reasonably calculated to reach the beneficial owners is "the best notice practicable under the circumstances", the class representative must advance the entire cost of that notice.

the complex and expensive machinery of a class action is often set in motion on behalf of persons with insubstantial claims, and the combination of "postage-stamp pleading" and the liberal discovery provisions of the Federal Rules makes class actions alleging violations of the federal securities laws particularly susceptible to this kind of abuse, see Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739, 741 (1975). In such circumstances, if the cost of identifying the members of the class on whose behalf the self-appointed representative sues is to be assumed by the securities industry, it will become not "overhead expenses necessary for responding to legitimate court orders," Blank v. Talley Industries, Inc., supra, p. 33, but an irresistible invitation to the commencement of groundless litigation by financially irresponsible plaintiffs who have nothing at risk.

Should the Court en banc reaffirm the panel's holding that the cost of identification of class members is part of the cost of notice, the present case is not an exception to the general rule laid down in Eisen IV that

> "Where ... the relationship between the parties is truly adversary, the plaintiff must pay for the cost of notice as part of the ordinary burden of financing his own suit."

417 U.S. at 178-79. The dissenting judge in Sanders viewed the pre-existing fiduciary obligation of the mutual fund to its shareholders as creating an exception to this rule permitting the costs of identification to be imposed on the fund in a class

action (slip op. at 4595-97, 21 Fed. Rules Serv. 2d at 1222).[19/] Even if this Court sitting en banc should carve out an exception to Eisen IV with respect to mutual funds, there is no basis whatsoever for extending such an exception to the brokers and other nominees on whom plaintiff seeks to impose the costs in this case. The class representatives here have no relationship, fiduciary or otherwise, to the persons from whom they seek the financing necessary to carry on this litigation, and those persons in turn have no duty to the class representatives. Judge Platt held that

> "If anything, the facts in the case at bar present an a fortiori situation to the facts in the Sanders case because here the brokerage firms whose customers comprise a part of the class are not as involved as the mutual fund might be said to have been in the Sanders case."

(A226); accord, Weiss v. Drew National Corp., No. 75 Civ. 4816 (S.D.N.Y. July 19, 1976) (A172-178). We respectfully submit that that view is correct, no matter what may be the rule with respect to the duties of a mutual fund to its own stockholders. The brokers and nominees are complete strangers to this litigation, who are not before the Court in any capacity; indeed how any order purporting to impose these costs on them could be enforced is an unanswered question, see pp. 24-25, supra.

Subsequent to Blank and Clinton, the precise issue whether the class representative must advance the cost of

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19/ As the majority opinion points out, slip op. at 4583, note 3, 21 Fed. Rules Serv. 2d at 1216, Judge Hays seems not to have considered it significant that the Fund was not a party to the class action claims, although it was before the court by virtue of the derivative claims being asserted in the same action.

identification and forwarding to class members who held in "street" name to make possible the initial class action notice has been litigated in only three cases, all in this Circuit.[20/] In Weiss v. Drew National Corp., p. 36, supra, Judge Stewart held that "plaintiff, and not the brokerage firms, must bear the cost of notifying class members". In Jahre v. Rait, No. 74 Civ. 805 (E.D.N.Y. May 19, 1976), p. 23, supra, Judge Weinstein initially ruled that the costs should be borne by the non-party brokers, but vacated that order when a group of brokers commenced a special proceeding to object. The third was this case.

Where the "weight of authority" lies in the few District Court cases that have considered the issue is not, of course, controlling on this appeal. Rather, what this Court must decide is whether class actions alleging violations of the federal securities laws are to be financed by the plaintiffs who bring them, or subsidized by the securities industry. Fundamental fairness and sound public policy require that class representatives advance these expenses in the first instance.

Plaintiffs argue at some length that requiring them to advance the costs of identifying the class members they seek to represent would "create a major impediment to the prosecution of securities class actions." (Pl. Br. 16-18,

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20/ In Frankenstein v. McCrory Corp., No. 74 Civ. 727 (S.D.N.Y. April 13, 1976), discussed in the brief of the amici curiae, an order directing brokers to bear the expense of identification was modified by consent of the parties and the class representatives in fact agreed to reimburse the objecting brokers.

45-57). This same argument was forcefully advanced at all stages of the Eisen case (see, in particular, the vigorous dissent of Judge Oakes in Eisen III, 479 F.2d at 1024-25) and expressly rejected by both this Court and the Supreme Court. It must similarly be rejected where, as here, it is advanced in an effort to have plaintiffs' claims subsidized by innocent third parties.

Due process considerations aside, the notion that class actions should be subsidized by strangers is so obviously unjust that it need not be belabored. To the extent that the argument here rests on value judgments, express or implied, about the social utility of the "street name" system,[21] those arguments should be addressed to Congress.

21/ Plaintiffs, throughout their brief, attempt to create the impression that the principal purpose of the registration of securities in "street" name is concealment, see, e.g., pp. 5, 10, 12, 42; and that it represents a "private" arrangement between the broker and his customer "for their own purposes" (p. 44; see also pp. 2, 5, 19). Both of these assumptions are refuted by the SEC Street Name Study, which considered in detail the "important benefits to the nation's securities markets" which the current system provides, including the facilitation of transfer, and the ability to develop a national system for clearance and settlement, Final Report pp. 11-12. The Commission therefore recommended "that no steps be taken which would discourage the use of nominee and street name registration or diminish the benefits which the practice provides." Id. at 6.

CONCLUSION

Judge Platt's ruling, was correct for two reasons. First, unless the class representatives advance the cost of identifying the members of the class whose securities were registered in "street" name, notice will be Constitutionally defective, depriving any judgment that may hereafter be entered of binding effect. Second, the costs necessary to give the notice which due process requires should be advanced in the first instance by the class representatives, for reasons of fairness and sound public policy.

The order appealed from should be affirmed.

Dated: New York, New York
March 11, 1977

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In Re Franklin National Bank Securities Litigation	
ROBERT GOLD, on behalf of himself and on behalf of all others similarly situated, Plaintiff-Appellant, -and- LOUIS PERGAMENT, Intervenor-Plaintiff-Appellant, -against- ERNST & ERNST, et al., Defendants-Appellees.	76-7616 CERTIFICATE OF SERVICE

I hereby certify that on March 11, 1977 I caused two true copies of the Brief of Appellees to be personally served upon Milberg & Weiss, attorneys for plaintiff-appellant Gold and liaison counsel for plaintiffs, One Pennsylvania Plaza, New York, New York 10001 and copies to be served by U.S. mail, postage prepaid, upon each of the following:

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In Re Franklin National Bank
Securities Litigation

ROBERT GOLD, on behalf of himself
and on behalf of all others
similarly situated,

Plaintiff-Appellant,

-and-

LOUIS PERGAMENT,

Intervenor-Plaintiff-Appellant,

-against-

ERNST & ERNST, et al.,

Defendants-Appellees.

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